VALERO™

March 11, 2009

VIA E-MAIL

Edie Chang, Chief
Program Planning and Management Branch
Office of Climate Change
California Air Resources Board
1001 I Street
Sacramento, CA 95814
echang@arb.ca.gov

Re: ***Valero Energy Corporation's ("Valero") Comments on California Air Resources Board's ("CARB") Draft AB 32 Administrative Greenhouse Gas Fee Regulation ("Draft GHG Fee Regulation")***

Dear Ms. Chang:

On February 25, 2009, CARB Office of Climate Change held a workshop to discuss the Draft GHG Fee Regulation. This letter provides Valero's comments on the Draft GHG Fee Regulation as presented at the public workshop.

From the onset, it should be noted that Valero agrees with the concept of a fair, economy-wide, prospective, and transparent GHG Fee imposed to recover the reasonable costs of California's AB 32 administrative activities. To that end, Valero strongly believes that the state's GHG Fee program should have the following key overarching principles:

- the fee program should be broad-based and economy-wide;
- the fee program should be equitable;
- the fee should be emissions-based;
- program costs to be recovered by the fee should be reasonable, direct, and prospective, with the actual costs accurately determined and documented and transparent; and
- the fee should be transparent to the ultimate GHG emitter.

However, the approach currently taken by CARB in developing the GHG fee regulation concept and the draft regulatory language developed to implement that concept does not incorporate these key overarching principles, and therefore, is fatally flawed in this respect and several other respects as discussed below. Moreover, the Draft GHG Fee Regulation inequitably, disproportionally, and illegally targets refiners and fuel producers such as Valero. While CARB has stated that it expects that any increase in cost to this sector can simply be passed onto the consumer, Valero believes that such additional passed-on costs can only harm the already struggling California consumer in the form of higher energy costs.

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Valero's Specific Concerns with the Draft GHG Fee Regulation

Legal Basis for Assessing Fees Based on Fuel Production. The statutory citation in AB32 (Health & Safety Code § 38597) states the following:

> **"**The state board may adopt by regulation, after a public workshop, a schedule of **fees to be paid by the sources of greenhouse gas emissions** regulated pursuant to this division, consistent with Section 57001. The revenues collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division." (Emphasis added).

Fuels in and of themselves are not "sources of greenhouse gas emissions." The "source" of GHG emissions related to use of fuels is the facility or equipment in which the fuels are combusted. Combustion clearly does not occur at the producer/importer level as used by CARB in the Draft GHG Fee Regulation, so fuel producers and importers cannot be considered "sources of greenhouse gas emissions." Accordingly, Valero believes that the strict interpretation of this language is that CARB is only allowed to assess fees from sources of actual emissions and not from producers or importers of fuels, regardless of the fact that fuels may ultimately create emissions.

Moreover, this language suggests that the fee regulation should cover <u>all</u> sources regulated under AB 32. Such an approach would include sources subject to the mandatory GHG reporting regulation adopted in 2007 as well as sources in industry sectors that are identified in CARB's AB 32 Scoping Plan as slated for GHG emissions regulation.

GHG Fees Must Not Be Retroactive: At the two public workshops, CARB has repeatedly stated that the agency intends to recover funds for repayment of AB 32 program loans made to CARB and CalEPA from the Motor Vehicle Account, the Air Pollution Control Fund, and other state accounts. These loans were said to total approximately $57 million, and their repayment is proposed to occur over three years. The Draft GHG Fee Regulation now includes repayment of these funds.

Valero also believes that the additional revenue would be an improper tax because such revenue would exceed the cost of administering AB 32 for that year and would be levied for an unrelated revenue purpose.

For these reasons, any GHG Fee Regulation charges in the future that are in excess of the revenue required to administer AB 32 in any given fiscal year, and are not used for the purposes of carrying out AB 32, will constitute an unlawful and unauthorized tax.

No Sunset Provisions: At the last public workshop, Valero understood CARB to indicate that they do not intend to sunset the GHG Fee Regulation, regardless of the fact that the Cap-and-Trade program, when implemented in 2012, may require affected facilities to pay for GHG allocations. Valero strongly recommends that CARB include in the GHG Fee Regulation a sunset that would be triggered once the Cap-and-Trade program is enacted and implemented so that affected facilities are not paying twice.

Off-Site Emission at Refineries: Based on Valero's reading of the GHG Fee draft regulatory language, it appears that refineries must also pay emission fees for GHG emissions generated from petroleum coke, naphtha, and LPG related activities that will occur outside the fenceline. While these substances can be used as fuels, they may also be used as feedstocks, in which case, there may be no additional GHG emissions. Accordingly, Valero believes that there is no way for a refinery to track the location and ultimate end use of these products in order to assess fees under the GHG Fee draft regulatory language.

Fuel vs. Feedstocks - Double Counting of Natural Gas: At the last public workshop, Valero understood CARB to indicate, that all natural gas must be assumed to be used as fuel/energy and will be levied a GHG fee. This understanding appears to be reinforced by the GHG fee draft regulatory language as the it does not allow exemptions for natural that will be used as a feedstock. As such, under the Draft GHG Fee Regulation, it appears that a GHG fee could be levied against a refinery's hydrogen production since natural gas is typically used as a feed stock.

Additionally, the GHG fee draft regulatory language appears to have the related problem in that a refinery could be levied a GHG fee against the purchase of natural gas and the GHG emissions resulting from combustion of natural gas within the refinery.

Valero believes that it is not CARB's intention to include such potential double-counting scenarios in the GHG Fee Regulation, and therefore requests, that CARB clarify this in any future version of the regulation.

Assessment of Process Emissions: Based on Valero's reading of the GHG Fee draft regulatory language, it appears that refineries will need to provide two separate GHG emission inventories – one for process emissions for the GHG fee regulation and one for all covered refinery sources, including process emissions, under the recently enacted AB 32 Mandatory GHG Emission Reporting regulation. This will equate to requiring the preparation of two different GHG inventories, which is a waste of resources, and could lead to errors in the inventories.

CARBOB and Ethanol: The addition of renewable or low-carbon oxygenates is not recognized in the GHG Fee draft regulatory language. Accordingly, anything added to CARBOB, regardless of its life-cycle carbon intensity, will be assessed a fee as gasoline. This will penalize anyone blending gasoline with renewables or low-carbon fuels, including ethanol/gasoline blends such as E-10, even E-85, which may be counterproductive or in conflict with proposed Low Carbon Fuel Standard ("LCFS").

Transparency: CARB's approach to the GHG Fee Regulation would impose the fee in a manner that in many cases is far upstream of the actual point of GHG emissions. If the fee payer simply includes the fee as part of the cost of fuel sold to those downstream in the supply chain, the administrative costs of AB 32 implementation will never be clear to the ultimate GHG emitter – the source or individual that actually combusts the fuel and thereby releases CO2 to the atmosphere. This is in direct contrast to most, if not all, other state environmental fee programs, where the fee is imposed directly on the actual emitter/discharger, who can then see directly the costs for which it is responsible.

Valero believes that all AB 32 GHG fees and charges should be transparent to the ultimate fee payer (i.e., the entity responsible for release of the GHG emissions which were subject to the fee) in order to help assure accountability and to send clear price signals to the regulated community.

Enforcement: The GHG Fee draft regulatory language enforcement provisions do not recognize the "materiality concept" that has been incorporated into the recently enacted AB 32 Mandatory GHG Emission Reporting regulation. This concept recognizes that 100% accuracy is not possible and allows for the certification process to provide an indication of how "material" omissions may be and offer opportunity for corrections. The inventory data required to be collected under the GHG Fee draft regulatory language does not recognize materiality and consequently anything short of complete accuracy is subject to enforcement. Valero strongly urges that CARB incorporate this concept into the GHG Fee Regulation and be consistent

Litigation Fees: The GHG Fee draft regulatory language indicates that costs stemming from litigation (in defending AB 32 rulemaking) can be collected under the GHG Fee Regulation. Valero believes that this is improper and legally invalid in that potential litigants with standing are paying litigation costs for both sides, but also that fees collected are required to be used for administrative development of these regulations and not any subsequent litigation arising from improper administration. Accordingly, this provision should be removed from the GHG Fee Regulation.

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In conclusion, Valero would like to thank CARB for this initial opportunity to comment on the Draft GHG Fee Regulation and the draft regulatory language. While we strongly object to the current fee proposal and structure proposed by CARB, Valero is dedicated to continue working with CARB to develop a legally sound, reasonable, and broad-based GHG Fee.

In submitting these comments, Valero incorporates by reference all of its previous correspondences and comments to CARB, verbal and written, concerning AB 32, the GHG Fee Regulation, the proposed LCFS, and the AB 32 Scoping Plan. In addition, Valero supports and adopts as its own the written correspondences and comments submitted by the Western States Petroleum Association, AB 32 Implementation Group, CMTA, and California Taxpayers' Association to CARB. Valero reserves the right to supplement its previous comments as well as provide future comments during GHG Fee Regulation rulemaking process.

Please contact me at (210) 345-4620 or Scott Folwarkow at (916) 503-1639 if you should have any questions or need clarifications concerning Valero's comments.

Sincerely,

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DWS:mhh

cc: Jon Constantino, CARB
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